Testimony Regarding H.B. 5411: AAC Disproportionate Tax Liability under the Personal Income Tax
Testimony Opposing New Tax Expenditures in H.B. 5561, H.B. 5565, H.B. 6535, and H.B. 6536

Nicholas Defiesta, Ellen Shemitz, J.D., and Kenneth Feder
Finance, Revenue, and Bonding Committee
March 18, 2015

Senator Fonfara, Representative Berger, and distinguished members of the Committee:

Thank you for the opportunity to testify. We speak today on behalf of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to advance opportunity for Connecticut's children and families.

H.B. 5411 proposes to increase equity in Connecticut's personal income tax. Connecticut Voices for Children offers three different proposals to make the state personal income tax more equitable:

1. **Increase the progressivity of the income tax on high earners;**
2. **Restore the state Earned Income Tax Credit (EITC); and**
3. **Enact a state dependent exemption.**

1. <u>Increase the Progressivity of the Income Tax on High Earners</u>

Modifying Connecticut's top personal income tax bracket would raise significant revenue while imposing no new burden on low and middle-income earners. An analysis by the Institute of Taxation and Economic Policy in Washington, D.C. (ITEP) found that by adjusting the definition and rates of the top tax brackets, affecting the wealthiest 2 percent of taxpayers, the state could generate roughly $300 million in new revenue with nearly 40 percent of that amount paid for by the federal government rather than local taxpayers through deductibility of state income tax on the federal tax return. Doing so would increase the progressivity of Connecticut's personal income tax, which currently flattens out at incomes above $500,000. For a detailed analysis, please refer to Appendix A.

Raising top income tax rates could avert painful cuts to children and families. To close the deficit of over a billion dollars in the coming fiscal year, the Governor's budget proposes deep cuts to current State services. **Over half of the total savings proposed in the budget comes from cuts in services that support children and families.** These include:

- Eliminating HUSKY coverage for over 30,000 pregnant women and parents;
- Reducing local education support by $158 million, placing even more burden on taxpayers at the local level; and
- Imposing a 60% cut to State support for developmentally-disabled children who also suffer from emotional, behavioral, and mental health needs.

Revenues from new top rates would help avert these cuts (which are detailed in Appendix B).

Raising top income tax rates would make Connecticut's tax code more fair and progressive. A 2014 tax incidence report by the Connecticut Department of Revenue Services found that Connecticut households earning between $5,533 and $16,245 per year pay an effective overall tax rate of more than 26 percent, while the wealthiest households with incomes over $165,394 pay an effective overall tax rate of only 8 percent. Simply put, our tax system asks more from families who have less. Increasing the progressivity of the personal income tax would help ensure we do not overburden our poorest families with taxes, and would ask our wealthiest residents to pay their fair share.

2. <u>Restore the State Earned Income Tax Credit (EITC)</u>

Lower and middle-income taxpayers would also benefit from restoring the state EITC to its full amount as pledged. Nearly 200,000 low- and moderate-income families claimed the EITC in 2014. In fact, every town in Connecticut had a household claim the EITC. The average income of households claiming the state EITC was $17,649, and the average credit amount was $426. The EITC was also specifically highlighted in the recent DRS tax-incidence analysis as playing an important role in increasing the progressivity of Connecticut's tax code. Simply put, the EITC offers a much needed tax break to hundreds of thousands of low-income working Connecticut families.

While the state EITC was due to be restored to 30% of a filer's federal credit amount in FY 2016, the Governor's budget proposes maintaining the credit at its current 27.5% level for the next two years. Failing to restore the EITC to its full amount would cost Connecticut's hard-working and poorest families roughly $11 million per year. This money would, in turn, quickly flow back into local economies. Restoring the EITC to its full amount would help ensure that low-income workers are able to keep more of what they earn, making our tax system less regressive, and also help Connecticut's economy recover.

3. <u>Enact a State Dependent Exemption</u>

Finally, enacting a state dependent exemption would ensure that middle-income taxpayers who are caring for a child, elderly parent or disabled adult are no longer penalized, as they now are under Connecticut's tax structure. Under current law, a family caring for dependents will pay exactly the same amount in state personal income taxes as a family with the same income but without dependents (see the example below). This violates the fundamental tax principle of *horizontal equity*, that families in different situations should be taxed differently according to their situation.

Family A: 2 Dependents		**Family B: 0 Dependents**	
Earned Income:	$60,000	Earned Income:	$60,000
Dependent Expenses:	$18,000	Dependent Expenses:	$0
State income taxes:	$1,800	State income taxes:	$1,800
Net income:	**$40,200**	**Net income:**	**$58,200**

Moreover, Connecticut is one of only two states with an income tax that fails to offer a dependent exemption, totally ignoring the cost of caring for a dependent in its tax code. Out of 40 states with an income tax, just Connecticut and Pennsylvania fail to adjust their state tax code for the cost of raising a child or providing care for an elderly parent. A dependent exemption structured with a phase-out at higher incomes would provide a significant boost to middle-income caregivers.

Increasing top marginal rates, restoring the EITC, and enacting a dependent exemption would increase the vertical and horizontal equity of Connecticut's tax code, and help

maintain investments in essential State programs that support children and families without asking the poor to continue to pay more than their fair share.

Connecticut Voices for Children does not support the enactment of any new tax expenditures as described in H.B. 5561, H.B. 5565, H.B. 6535 and H.B. 6536. These new tax expenditures would cost the State much needed tax revenue in a year when programs for children and families are already facing painful cuts. In the event any new tax expenditures are enacted, we urge that also include a sunset provision of no more than six years. Including sunset provisions would increase transparency, and place tax expenditures on par with appropriations in terms of legislative review. It would enable the Connecticut General Assembly to truly balance the various fiscal needs of the state (A summary of all cuts to children's programs is presented in Appendix B. A summary of revenue options to offset cuts is included in Appendix A.)

Moreover, we ask the Committee to consider enacting automatic sunset dates for *all* tax existing expenditures, so that they are subject to the same scrutiny as traditional appropriations. Tax expenditures should require regular review and re-approval by the General Assembly, just like other expenditures that are considered and approved regularly through the appropriations process. By sun-setting all tax expenditures, and requiring an affirmative vote to protect any particular exemption, the Legislature could prevent the loss of hundreds of millions each year on tax breaks that may no longer have any policy justification.

Finally, we ask the Committee to eliminate specific tax expenditures that we have identified as outdated and/or baseless: those that either have been found to offer no significant public benefit (as determined in the 2014 report by Connecticut's Office of Fiscal Analysis) or were enacted decades ago for services that no longer require special treatment. For instance, Connecticut could avert both the $49.2 million cut to the HUSKY program *and* the $11 million cut to the EITC by repealing an obsolete tax expenditure enacted in 1997 at the dawn of the internet revolution to encourage a rapid buildup in Internet services. (A summary of major tax expenditures that could be reclaimed to raise revenue, totaling over $470 million, is included in Appendix A.)

The table below illustrates how eliminating tax expenditures and increasing the progressivity of the personal income tax could enable to state to avoid harmful budget cuts which essentially ask children to close the State's budget deficit:

Proposed Cut	Cut (millions)	Revenue Option	Revenue (millions)
HUSKY A coverage for parents and pregnant women	**-$49.3**	Repeal 1997 tax expenditure for Internet services	**+$62.2**
State Department of Education and higher education	**-$219.4**	Adjust top marginal income tax rates	**+$300**
Department of Developmental Services' Voluntary Services	**-$20.0**	Eliminate 1999 tax expenditure on home renovations and restoration	**+25.2**
Earned Income Tax Credit (EITC)	**-$11.0**	Eliminate tax expenditures: athletic clubs (1994) and lawn bowling clubs (1999)	**+$11.2**

Thank you for your time. We would be happy to answer any questions.

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CONNECTICUT VOICES FOR CHILDREN

Funding Our Future: Child and Family Friendly Revenue Options

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Proposed cuts to Connecticut's budget will hurt many: among them children who need good teachers, pregnant women and parents who need health insurance, and disabled and elderly residents who need caring services. While the Governor tried to reduce the need for some budget cuts by decreasing tax benefits for businesses, and while he has proposed modest tax relief for low and middle income families by cutting the sales tax rate, his proposal fails to protect critical programs and services for children and families. Over half ($316 million) of the $590 million in total proposed cuts reduce state investment in the health, education, well-being and prosperity of children and families across Connecticut.[1]

In addition to the harm caused by direct program cuts, the budget further falls short by failing to take bolder steps to redress existing inequities in Connecticut's tax system. A recent tax incidence report by the Connecticut Department of Revenue Services found that Connecticut's lower-income families pay more than three times the share of their income in state and local taxes as the state's high-income residents. Households making between $5,533 and $16,245 pay an effective overall tax rate of over 26 percent while the wealthiest households, with incomes over $165,394, pay an effective overall tax rate of only 8.18 percent.[2] Simply put, our tax system imposes a greater burden on those families who have less.

Better choices exist. Strategic tax reforms would allow us to avoid deep cuts to essential services and improve the equity of the existing state and local revenue system. The reforms listed below address both tax expenditures and tax revenues.

1. **"Sunset" tax expenditures.** The term "tax expenditure" refers to special tax treatment given to some taxpayers through exemptions, deductions and credits. These tax expenditures currently total over $6 billion in lost state revenue every year, nearly one-third of our state's annual appropriations. Yet, unlike spending through the appropriations process that is reviewed each and every year, tax expenditures are not reviewed annually, or even periodically, and only rarely are they repealed. Without such review, there is no way to assess whether the revenue that policymakers have chosen to exempt from taxation might be better used for some other purpose.

   Many tax expenditures, such as those exempting groceries from the sales tax, are consistent with principles of a high quality state revenue system. [4] Others, however, may advance no clear public benefit. Rather than allowing

[1] Connecticut Voices for Children, "Impact of the Governor's FY 2016 Budget on Children," (February 2015) http://www.ctvoices.org/sites/default/files/bud15impactgovbudgetfy16.pdf.
[2] Department of Revenue Service, "Connecticut Tax Incidence," (December 2014), http://www.ct.gov/drs/lib/drs/research/drstaxincidencereport2014.pdf.
[4] As defined by the National Conference of State Legislatures. See: National Conference of State Legislatures, "Principles of a High-Quality State Revenue System," (June 2007), http://www.ncsl.org/research/fiscal-policy/principles-of-a-high-quality-state-revenue-system.aspx.

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existing tax expenditures to remain on the books without review, the General Assembly could enact a universal "sunset" provision to terminate all current tax expenditures and require re-authorization of those the General Assembly deem to have current merit. Universal sun-setting would increase transparency in the tax system, provide a means to eliminate tax expenditures providing no ongoing public benefit, and raise significant revenue to fund programs that do provide broad public benefit.

Other states sunset or regularly review their tax expenditures. In Oregon, for example, tax expenditures expire after six years unless legislators vote to renew them.[5] In Washington, legislators hold annual committee meetings with the purpose of reviewing all tax expenditures.[6] And in Rhode Island, the Governor's budget proposal is required to include recommendations on the continuation of all tax expenditures, which are then debated by the Legislature.[7] By adopting some variation of sun-setting, our Legislature could advance both equity and transparency while raising significant revenue without any new taxes or changes to existing tax rates.

2. **Eliminate specific tax expenditures**. In addition to, or in lieu of automatic sun-setting, the General Assembly could repeal specific tax expenditures. The Office of Fiscal Analysis' 2014 Tax Expenditure report lists the rationale behind the passage of each current tax expenditure. For many, the rationale OFA states is either political expediency[8] or economic incentive (too often for goods or services that no longer require special treatment). Eliminating such tax expenditures – including nearly $140 million to foster the computer and data processing industry enacted in 1994, roughly $70 million to benefit amusement and recreation enterprises passed in 1993, and over $60 million to support Internet services at the start of the internet revolution in 1999 – would provide significant state revenue and eliminate state expenditures inconsistent with the public interest.

   Connecticut Voices for Children has reviewed the OFA report and identified a total of over $470 million in individual tax expenditures that could be eliminated to provide additional state revenue without any downside to the public interest. See Appendix 1 for a detailed list.

3. **Broadening the base of the sales tax on services.** While the sales tax applies to the sale of goods unless exempted, the sale of any specific service is not taxed unless explicitly included in the statute. Connecticut's sales tax (currently 6.35%) should be updated since services comprise an increasingly large part of our economy. Moreover, broadening the sales tax base to include services could enable a *significant* decrease in the sales tax rate while maintaining a neutral or positive overall effect on the state's budget outlook. Such a drop in the sales tax rate – potentially to 5.25% or lower, depending on the extent of base broadening undertaken – would also increase our competitiveness in relation to Massachusetts (6.25%), New Jersey (7%), and Rhode Island (7%). Such increased competitiveness could spur cross-border sales, creating a boon to area businesses, putting more dollars in the local economy and possibly supporting job growth.

4. **Adjust top marginal rates on the state's highest incomes.** Connecticut's personal income tax is progressive for families making less than half a million dollars a year; but for those making more, the tax becomes flat. The result is that the state asks less from those who can afford to pay more. Significant revenue could be raised by extending progressivity further up the income ladder, with the precise amount of revenue depending on the specific corrections. The state holds substantial room to raise top income rates due to Connecticut's relatively low top marginal rate of 6.7%, compared to New York (8.82%), New Jersey (8.97%), and Vermont (8.95%).[9] Moreover, the state's personal income tax is deductible from a taxpayer's federal income tax, meaning that an increase in state rates will be partially offset by a decrease in federal tax liabilities. By leveraging federal dollars, increased progressivity would cost taxpayers significantly less than the net benefit to the state.

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5 Oregon House Bill 2067, Regular Session (2009).
6 Revised Code of Washington § Chapter 82.32.808 (Washington State Legislature 2014)
7 State of Rhode Island General Laws § Section 44-48.2-5 (State of Rhode Island General Assembly 2014).
8 Defined in the report as "Expenditures of this type violate one or more of the principles of a high-quality revenue system without any apparent counterbalancing or compensating precept."
9 CCH Editorial Staff. *2015 State Tax Handbook*. Commerce Clearing House, Dec. 2015. Web. 23 Feb. 2015.

An analysis[10] by the Institute of Taxation and Economic Policy (ITEP) of Washington, D.C. found that adjusting top rates to the levels in the table below would impact only two percent of state taxpayers, generate $300 million in state revenue, enable taxpayers with increased state taxes to deduct $114 million from federal tax returns, leaving only $186 million borne by Connecticut taxpayers.

Increased Progressivity at High Incomes			
MFJ	Single/MFS	HOH	Rate
$0	$0	$0	3%
20K	10K	16K	5%
100K	50K	80K	5.5%
200K	100K	160K	6%
400K	200K	320K	6.5%
500K	250K	400K	7%
1M	500K	800K	7.5%

Additional information, including a detailed breakdown of the distribution of this tax change, can be found in Appendix 2.

5. **Enact combined reporting.** Connecticut is the only state in the Northeast that does not require combined reporting – a fix of an existing tax loophole that allows corporations that conduct business in multiple states to use accounting gimmicks to avoid paying state taxes. Enacting combined reporting legislation would require companies to report multistate income and expenses together, closing this loophole. Doing so eliminates an unfair advantage for multistate corporations over small businesses that only conduct business in Connecticut and increases the state tax base using newly reported state corporate profits.

   While official revenue estimates from enacting combined reporting are difficult to produce, official revenue estimates from other states that have recently adopted or considered combined reporting[11] have indicated that combined reporting increases net corporate tax revenue by an average of 16.6 percent — $129.8 to $149.5 million annually in Connecticut, depending on whether the Governor's proposed changes to the corporation tax are enacted.[12]

6. **Raise the cigarette tax.** Supported by 70 percent of voters in a 2013 poll[13], raising the cigarette tax by 95 cents would promote public health while generating an estimated $60 million in revenue, according to an ITEP analysis. At $3.40, Connecticut's cigarette tax lags behind neighboring states, including $3.51 in Massachusetts, $4.35 in New York, and $3.50 in Rhode Island.[14] See Appendix 3 for a detailed breakdown of the tax impact.

7. **Introduce a sugar-sweetened beverage and candies tax.** As originally introduced, Proposed Bill No. 5461 would have imposed a tax on soft drinks (of one cent per ounce) and candy, dedicating the money raised to childhood obesity prevention efforts, municipalities, and the Governor's scholarship program. According to an ITEP analysis, the bill as initially introduced would create a large public health benefit while raising an estimated $179 million: a figure that will need to be recalculated based on the final language of any legislation. See Appendix 4 for a detailed tax impact breakdown of the original proposal.

[10] Analysis performed by ITEP at the request of Connecticut Voices for Children.
[11] Iowa, Maryland, Massachusetts, New York, Wisconsin
[12] According to the Governor's FY 2016-17 Budget Proposal, Connecticut received $782.2 million in its Corporation Tax in 2013-14 and can expect to receive $900.5 million in 2015-16 given recommended policy changes.
[13] "Poll: 70 Percent of Connecticut Voters Support Raising the Tax On Cigarettes." PR Newswire. N.p., 15 May 2013. Web. 23 Feb. 2015.
[14] CCH Editorial Staff. *2015 State Tax Handbook*. Commerce Clearing House, Dec. 2015. Web. 23 Feb. 2015.

Appendix 1: Proposed Tax Expenditures to Eliminate

Connecticut Voices for Children reviewed the OFA report and highlighted tax expenditures based on four bases.

- First, Voices identified tax expenditures with a cited rationale of "incentive" which were found to be outdated, as in the case of the "Computer and Data Processing" tax expenditure.
- Second, Voices identified expenditures rationalized as "incentive" which lack sufficient offsetting public benefit, as in the case of "Winter Boat Storage."
- Third, Voices highlighted those expenditures enacted for "Expediency," defined in the Tax Expenditure Report as violating one or more principles of a high-quality revenue system without offering sufficient offsetting public benefit.
- Finally, Voices identified tax expenditures enacted for "perceived equity" for which sufficient public benefit could not be identified.

Tax Expenditure	Year Enacted	Revenue gain from repeal (millions)	Cited Rationale
Computer and Data Processing	1994	$137.7	Incentive
Diesel Fuel First Sale	2007	$93.0	Expediency
Amusement and Recreation Services	1993	$70.0	Expediency
World Wide Web (Internet services)	1997	$62.2	Incentive
Motor Vehicles & Vessels Purchased by Non-Residents to use Out of State	1987	$43.4	Incentive
Renovation & Repair for Residential Property	1999	$25.2	Expediency
Health and Athletic Club Services	1994	$10.7	Expediency
Car washes	1993	$6.8	Expediency
Digital Animation Production	2007	$6.7	Incentive, Expediency
Sale of Certain Credits	1999	$6.2	Expediency
Charges for Athletic Instruction	1975	$2.7	Expediency
Massage Therapist and Electrology Services	1992	$2.6	Perceived Equity
Winter Boat Storage	1993	$2.4	Incentive
Carnival or Amusement Rides	1994	$1.6	Expediency
Media Payroll Services	2007	$1.2	Expediency
Health Club Charges	1975	$1.2	Expediency
Ocean Marine Insurance	1967	$0.8	Expediency
Charges for Instruction	1975	$0.8	Expediency
Vessels Brought in to the State for Storage, Maintenance or Repair	1983	$0.7	Incentive
Lawn Bowling Clubs	1999	$0.4	Expediency
Total:		**$476.3**	

Source: CT Department of Fiscal Analysis 2014 Tax Expenditure Report

Appendix 2: Detailed Income Tax Rate Adjustment Impact

2014 Income Level	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $26,000	$26,000 – $47,000	$47,000 – $79,000	$79,000 – $129,000	$129,000 – $296,000	$296,000 – $1,423,000	$1,423,000 – Or More
Average Income	$14,000	$36,000	$61,000	$100,000	$178,000	$568,000	$3,751,000

Option 4: Higher Marginal Income Tax Rates and New Tax Bracket							
Tax Change as % of Income	—	—	—	—	+0.0%	+0.1%	+0.5%
Average Tax Change	—	—	—	—	+0	+499	+19,271

% with Income Tax Increase	—	—	—	—	+0%	+29%	+100%
Avg. Tax Increase for those with increase	—	—	—	—	+30	+1,735	+19,342
Share of Tax Increase	0%	0%	0%	0%	0%	12%	88%

State Revenue Change ($1000)
+300,000

Fed Offset	Federal Tax Change ($1000)
-38%	–114,000

Total Tax Change to Taxpayers ($1000)
+186,000

% of Taxpayers w/Increase	2%
Share of Bottom 80% with Increase	0%
Share of Top 20% with Increase	10%

Share of Hike Paid by Bottom 80%	0%
Share of Hike Paid by Top 20%	100%

Appendix 3: Detailed Cigarette Tax Increase Impact

2014 Income Level	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $26,000	$26,000 – $47,000	$47,000 – $79,000	$79,000 – $129,000	$129,000 – $296,000	$296,000 – $1,423,000	$1,423,000 – Or More
Average Income	$14,000	$36,000	$61,000	$100,000	$178,000	$568,000	$3,751,000

Option 6: Increase Cigarette Tax by 95 cents							
Tax Change as % of Income	+0.2%	+0.1%	+0.1%	+0.0%	+0.0%	+0.0%	+0.0%
Average Tax Change	+25	+26	+33	+37	+43	+53	+64
Share of Tax Hike	14%	15%	18%	21%	18%	6%	1%

State Tax Change ($1000)
+60,000

Appendix 4: Detailed Sugary Beverage and Candy Tax Impact

2014 Income Level	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $26,000	$26,000 – $47,000	$47,000 – $79,000	$79,000 – $129,000	$129,000 – $296,000	$296,000 – $1,423,000	$1,423,000 – Or More
Average Income	$14,000	$36,000	$61,000	$100,000	$178,000	$568,000	$3,751,000

Option 7: Add a 1 cent per ounce consumption tax to Added Sugar Beverages and Candy							
Tax Change as % of Income	+0.3%	+0.2%	+0.2%	+0.1%	+0.1%	+0.0%	+0.0%
Average Tax Change	+45	+83	+94	+126	+166	+199	+279
Share of Tax Hike	8%	15%	17%	24%	23%	8%	2%

State Tax Change ($1000)
+179,000

FISCAL POLICY CENTER

At Connecticut Voices for Children

Impact of the Governor's FY 2016 Budget on Children

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I. Introduction

A third of Connecticut's General Fund is spent on children, yet over half of the cuts in the Governor's proposed budget for Fiscal Year 2016 are in funding that supports Connecticut's children and their families. These cuts, totaling $316.4 million, are part of a larger proposal to close the State's deficit of over $1 billion in the coming fiscal year. The deficit is partially a result of contractually obligated expenses, such as state employee fringe benefits and interest due on the money Connecticut borrowed in previous years. But just as we must keep our promises to retired workers and to our lenders, we must also maintain our promise to the next generation: that every child will be able to grow up healthy, safe, and with the opportunity to reach his or her full potential. While the Governor's budget proposal attempts to offset some of the most painful cuts with new revenues, overall children and their families are being asked to foot more than their share of the State's fiscal woes.

To track the impact of Connecticut's budget on children, Connecticut Voices for Children constructed the "Children's Budget" – a compilation of all major State investments in children, including programs that provide for the well-being of children and their families. Using the Children's Budget, we can examine the Governor's proposed budget and determine whether the State plans to remain firm in its commitment to invest in children and families during difficult times.

Unfortunately, the proposed budget makes significant cuts that will hurt the safety, health, and education of Connecticut's children, with a total reduction of $316.4 million (5.1% of the Children's Budget), including:

- $158.0 million from the State Department of Education (mostly from capping statutory formula grants, which provide reimbursement to towns for critical education and related services)
- $49.3 million from the HUSKY health insurance program for children, families, and pregnant women
- $61.4 million from higher education (the Board of Regents, University of Connecticut and Office of Higher Education)
- $15.7 million from the Department of Children and Families

These cuts in proposed appropriations are exacerbated by decreases in tax breaks that benefit working families, including a delay in fully restoring the State's Earned Income Tax Credit, which provides targeted financial help to our lowest-income working parents. While some new revenues are proposed to close the deficit – notably, capping corporations' use of net operating losses to reduce their tax liability and capping the use of tax credits by corporations and hospitals to reduce their tax liability – more should be done to avoid balancing the budget on the backs of children and families.

In short, as has too often been the case, the proposed budget asks our next generation to take on far too much of the bill for the State's deficits. A balanced approach would instead rely more heavily on equitable revenue increases to help preserve and expand important investments in children that the proposed budget puts in jeopardy.

II. Changes to the Children's Budget

The Children's Budget did not fare well in the Governor's budget proposal for FY 2016, decreasing by 5.1% from current services levels[1] (approximately $316.4 million), as compared to an overall 2.2% decline for non-child and family related budget items. Over half of this Children's Budget decline comes from cuts to the State Department of Education ($158 million), with substantial cuts coming from funding for the Department of Children and Families ($15.7 million), Medicaid/HUSKY A ($49.3 million), Voluntary Services in the Department of Developmental Services ($20 million), and higher education ($61.4 million). **While the Children's Budget comprises a third of the General Fund, over half (53.5%) of the Governor's proposed cuts come from items in the Children's Budget.**

	FY 2016 Current Services	FY 2016 Proposed[2]	Change from Current Services	Percent Change
Young Children				
State Department of Education	$3,209,426,866	$3,051,406,083	-$158,020,783	-4.9%
Office of Early Childhood	$277,262,440	$270,766,769	-$6,495,671	-2.3%
Department of Children and Families	$828,498,662	$812,820,810	-$15,677,852	-1.9%
DSS Medicaid (HUSKY A)[3]	$805,459,200	$748,914,800	-$49,294,400	-6.1%
DSS TANF	$104,370,000	$102,625,380	-$1,744,620	-1.7%
DSS HUSKY B (CHIP)	$33,690,000	$33,690,000	$0	0.0%
DSS CT Children's Medical Center	$15,579,200	$15,579,200	$0	0.0%
DDS Early Intervention	$39,186,804	$39,186,804	$0	0.0%
DDS Voluntary Services	$33,017,277	$12,986,713	-$20,030,564	-60.7%
DOL Jobs First	$18,051,623	$18,040,423	-$11,200	-0.1%
DPH School-Based Health Clinics	$12,048,716	$11,024,576	-$1,024,140	-8.5%
Youth				
Board of Regents	$353,813,840	$336,774,676	-$17,039,164	-4.8%
University of Connecticut	$258,812,447	$219,377,020	-$39,435,427	-15.2%
Office of Higher Education	$47,178,537	$42,276,326	-$4,902,211	-10.3%
DOL Workforce Investment Act	$31,284,295	$31,284,295	$0	0.0%
DMHAS Young Adult Services	$82,898,847	$80,206,667	-$2,692,180	-3.3%
JUD Juvenile Alternative Incarceration	$28,442,478	$28,442,478	$0	0.0%
JUD Youthful Offender Services	$18,177,084	$18,177,084	$0	0.0%
Total Children's Budget	**$6,197,198,316**	**$5,873,580,104**	**-$316,368,212**	**-5.1%**
Non-Children's Budget	**$12,394,901,684**	**$12,128,219,896**	**-$266,681,788**	**-2.2%**
General Fund	**$18,592,100,000**	**$18,001,800,000**	**-$590,300,000**	**-3.2%**

III. Fringe Benefits, Debt Service, and Rainy Day Fund

In contrast to the cuts to the Children's Budget, the proposal maintains commitments to our contractual obligations, including payments to employee pensions, health care, and debt service. The Governor's proposal maintains the state's contribution to the State Employee Retirement System (SERS) at a current services level of $1,097 million FY 16, up $127 million from FY 15. It also funds at current services level the healthcare costs of current and retired employees for a total of $1,366 million in the upcoming fiscal year, representing growth of $145 million from the previous year. Payments owed on Connecticut's debt, meanwhile, are set to grow $143 million to a level of $1,651 million. Altogether, these three items account for $413 million in current services growth and 22.8% of the General Fund.

Finally, the proposal deposits just $3.2 million into the state's Budget Reserve Fund, commonly known as its Rainy Day Fund, which currently holds $519.2 million, just 2.9% of proposed FY 16 expenditures.

IV. Health

The Governor's proposed budget makes significant cuts totaling an estimated $49.3 million (6.1%) to Connecticut's HUSKY health insurance program. Most notably, the proposed budget would eliminate Medicaid (HUSKY A) coverage for over 30,000 pregnant women and parents of children on HUSKY with incomes above 138% of the federal poverty line (about $33,000 per year for a family of four).

The Governor's budget proposal assumes that these parents and pregnant women will be able to purchase insurance through the Access Health CT marketplace. Research shows, however, that many of these adults are unlikely to find comprehensive, affordable insurance. Families will forego purchasing coverage or accessing care due to new co-pays and other out-of-pocket costs that they are not asked to pay under HUSKY. The result will undermine the gains Connecticut has made in the last decade reducing the number of uninsured residents. This risk goes beyond the adult population: we know from national research and the experience of other New England states that when parents lose health insurance coverage their children are at risk of also becoming uninsured and not getting the care they need. In addition, newborns will lose automatic coverage that is tied to their mothers' eligibility for HUSKY A.

The Governor proposes to eliminate coverage for children in HUSKY B whose families pay an unsubsidized rate to buy into the program. Currently, these families have a choice of purchasing coverage through HUSKY B or commercial coverage offered through Access Health CT.

While the Governor's budget proposes to maintain the increased Medicaid reimbursement rates for primary care providers, the budget makes hundreds of millions in additional cuts by eliminating Medicaid rate increases to other health care providers and inflation adjustments scheduled to go into effect in FY 16, and by annualizing rescissions imposed in FY 15. Without adequate reimbursement, the pool of providers willing to provide care will likely decline, leading to problems gaining access to necessary health care despite having health insurance.

Outside the HUSKY program, cuts are also imposed on important health services for children and young adults. Included in these cuts are:

- The elimination of funding for Healthy Start ($1.4 million) which provides case management for pregnant women, new mothers and their babies on HUSKY, with a focus on reducing adverse health impacts from high risk pregnancies
- Reduced funding for the Young Adult Services program within the Department of Mental Health and Addiction Services (DMHAS) by $2.7 million (3.3%)
- A reduction in funding for school based health centers by $1 million (8.5%)

Finally, the proposed budget would eliminate funding for Independent Performance Monitoring of the HUSKY program ($208,050), a small but important and longstanding effort to ensure that scarce public dollars spent on the HUSKY program are actually providing children and families access to needed care.

V. Education

The Governor's proposed budget would reduce spending on K-12 Education by more than $158 million (4.9% of all State K-12 spending). The lion's share of these cuts comes from capping statutory formula grants, which provide reimbursement to towns for important services such as special education and transportation. However, capping these grants may not save taxpayers money. Many of the previously state-funded services are essential, and in some cases legally required, in order to provide all children access to an adequate education; loss of state funding simply passes costs down to local taxpayers.

The Governor's proposal further harms children, families and towns by ending its practice (over the last three years) of increasing the Education Cost Sharing (ECS) grant for general education, the State's principal form of education aid to towns, by around $50 million per year. Most of the annual increases were directed to "Alliance" school districts, the thirty school districts where students have the lowest standardized test scores. These districts are located in some of Connecticut's poorest towns, and struggle to provide their students with an adequate education. The State should not retreat from its effort to adequately fund these already under-resourced schools. Yet, this budget includes no funding increase, capping grants and effectively downshifting state responsibilities to the local level.

While the proposed budget does fund statutory commitments to create 1,800 new seats in inter-district magnet schools and 1,250 new seats in charter schools in FY 2016, the budget also extends a cap on magnet school funding, reducing State operating support for these schools by $1.9 million.

The proposed budget does appropriate $1 million to finance expansion of the School-Based Diversion Initiative (SBDI), a program designed to reduce in-school arrests, expulsions and out-of-school arrests as part of the Second Chance Society Initiative. SBDI will facilitate changes to school discipline policies that keep more children in school rather than excluding them for minor disciplinary infractions.

The Governor's proposed budget for Higher Education makes cuts totaling $61.4 million to the Office of Higher Education, the University of Connecticut, and the Board of Regents for Higher Education. These cuts are achieved primarily through reduction of block grant funding generally dedicated to operating costs at the University of Connecticut, reduction in the Next Generation Connecticut Program (the Governor's initiative to expand education and research in STEM fields), elimination of the Governor's Scholarship Awards to Students Attending Private

Institutions, and reduction of funding for the Transform CSCU 2020 Program. These cuts represent 9.3% of the State's current general fund spending on higher education.

VI. Early Care and Education

The Governor's budget proposal for FY 16 maintains funding for School Readiness, the state's largest subsidized preschool program, and for Care4Kids, the state's largest child care subsidy program.[4] The proposal does decrease the Smart Start Pre-school Expansion program by 50% ($5 million), but the Smart Start program, combined with the Federal Preschool Expansion Grant awarded to Connecticut in December,[5] will still allow the state to create up to 1,400 high-quality preschool slots in FY 16. In addition, the budget proposal earmarks funds (that were previously dedicated to Care4Kids) for an Early Head Start–Child Care Partnership, allowing Connecticut to access $3.4 million in federal funding for low-income families.[6] The Governor's proposal demonstrates his continued commitment to expanding high-quality early care and education, particularly to at-risk children.

However, the Governor's budget proposal reduces funding targeted for quality improvements across the state's early education network, which is of concern as studies show that the multiple long-term benefits reaped by early care and education are only realized if programs are of high quality. In particular, the budget proposal decreases funding for School Readiness Quality Enhancement by 5% ($0.26 million) and eliminates funding for Improving Early Literacy ($0.15 million). It additionally eliminates funding for Wraparound Services ($0.45 million) and Parent Universities ($0.49 million)[7], both programs that recognize the need for a two-generation, holistic approach to early education.

The Governor's budget also includes a proposal to offer full-day kindergarten to every child in Connecticut by fall 2017. Full-day kindergarten is a necessary complement to the expansion of high-quality early care and education. Research shows that students who attend full-day kindergarten do better in reading and mathematics than their half-day counterparts, and that full-day kindergarten particularly benefits low-income and minority students.[8] As the state expands its subsidized early care and education, it is critical that all children also have access to full-day kindergarten so that the achievement gains made in the first five years do not fade away. However, full-day kindergarten must be funded in a way that does not come at the expense of students in grades 1-12.[9]

VII. Child Welfare and Juvenile Justice

The Governor's proposed budget includes a $15.7 million cut from FY 2015 to the state's Department of Children and Families (DCF), a 1.9% reduction to existing services. This decline results primarily from reductions in congregate care capacity ($2.6 million), elimination of private residential treatment rate increases ($3.4 million), and making permanent the Governor's rescissions from earlier in 2015 ($1.8 million).

The budget also includes a significant realignment of juvenile justice services, including a $114 million transfer of juvenile programs from the Judicial Department's Court Support Services Division (CSSD) into the Department of Children and Families (DCF). This transfer includes a $9.9 million cut to juvenile programs. (Because of this transfer, the DCF budget appears to grow from $828 million to $929 million on paper.)

The DCF budget has been falling for several years now, threatening the well-being of our state's most vulnerable children and families. Successive years of funding cuts, coupled with an increasingly complex caseload, have placed increasing strain on the agency. In fact, DCF remains under federal court supervision to meet the needs of children in its care; the federal court-appointed monitor continues to caution against efforts to save money by reducing congregate care and caseloads absent meaningful investment in frontline staffing and development of services that meet the complex needs of those children remaining in care.[10] The state's failure to adequately invest money into DCF to improve care quality is jeopardizing the well-being of our state's most vulnerable children to whom we owe a special responsibility.

VIII. Revenues

The Governor's proposed budget makes substantial changes on the revenue side of the balance sheet, including the following tax changes to current law:

- Postpone full restoration of Earned Income Tax Credit (EITC): $11 million
- Cap corporations' use of Net Operating Loss in calculating tax liabilities: $156.3 million
- Limit the amount by which corporations and hospitals can use tax credits to offset their tax liability to 35%: $77.5 million
- Update the Hospital Provider Tax to reflect FFY 2013 net patient revenues and to equalize the tax rate on in- and out-patient services: $165.2 million (this change will increase federal Medicaid reimbursements to Connecticut)
- Maintain the 20% surcharge on corporate business taxes indefinitely: $44.4 million
- Eliminate the sales tax exemption on clothing and footwear: $138 million
- Reduce the sales tax rate from 6.35% to 6.2% on 11/1/2015: -$70.1 million

Rather than impose these painful spending cuts on children and families, the State should work to end outdated or wasteful tax expenditures. Instead, the proposed budget limits tax expenditures that would benefit children and families. The state EITC is a highly effective anti-poverty program that benefits working low-income families in all 169 of Connecticut's towns, awarding an average benefit of over $400 to roughly 190,000 households with an average income of $17,649.[11] The proposed budget eliminates a planned restoration of the EITC, leaving the tax credit at a level below the amount established in 2011 – 30% of the federal EITC benefit. At a time when Connecticut's poorest residents are still hurting from the recession, Connecticut should maintain its investment in this important program, and keep its promise of full restoration of the EITC. Full restoration would have the additional benefit of supporting our economic recovery, as research shows that EITC funds are quickly spent.

The budget does propose a reduction in the sales tax rate from 6.35% to 6.2% in November of 2015. To the extent this change is intended to minimize the overall regressive nature of the state revenue system, it is undermined by the elimination of the sales tax exemption on clothing and footwear. Eliminating sales tax exemptions that lack strong rationales (such as efficiency) is generally good tax policy; however, such eliminations should be far more extensive, not limited to taxation of consumer goods.

Some optimistic assumptions regarding increases in personal income tax revenue are built into the Governor's budget proposal. Income tax collection is assumed to grow from $8.7 billion in FY 14 to an estimated $9.3 billion in FY 15 to a projected $9.7 billion in FY 16, increases of 5.9% and 5.2% respectively. Should these revenues fall below expectation, further cuts may become necessary. On the whole, the budget is overly reliant on spending cuts to close the State's projected deficit. The revenues proposed are insufficient to avert painful cuts to children's programs and, in some cases, make our tax system more regressive through measures such as delaying EITC restoration.

IX. Conclusion

The State has an obligation to close its deficit and pay down its debts, but Connecticut also has an obligation to its children and families – an obligation to ensure that no child wants for basic needs, every child has access to needed healthcare, and every child receives a high quality education. This intergenerational exchange is the lifeblood of a strong society. If we renege on this debt to our children, we put them at risk for a lifetime of poverty, illness, and economic hardship, putting our state's long-term prosperity at risk.

Over the last 30 years, Connecticut's income distribution has grown increasingly unequal, as the income of middle and lower-income families stagnate or decline and the incomes of our highest income families increase. When we allow equalizing public investments in children's healthcare and education to erode, we run the risk that more children will be shut out of economic opportunity simply because of the circumstances of their birth. Unfortunately, the proposed budget asks children to foot too much of the bill for the State's deficit. A more balanced approach to forming the budget, one which relies more heavily on expanded progressive revenues, would afford us greater opportunity to make essential investments in our children and our future success.

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[1] Current services denotes the level of funding required to maintain services at the level they were the previous year given routine changes such as inflation and caseload adjustments.

[2] To ensure accurate comparisons to current services levels, some of the proposed appropriations for FY 2016 were adjusted to reflect transfers from one agency to another. For example, the Early Intervention program, previously housed in the Department of Developmental Services, was split between the Department of Social Services and the Office of Early Childhood in the Governor's budget proposal. This appropriation was subtracted from the line items for both DSS and OEC to maintain accurate year-over-year comparisons.

[3] The Governor's FY 2016-17 proposed budget does not delineate the portion of Medicaid funding spent on children and families, so this amount represents the best estimate given the most recent data available. It assumes all funds cut from HUSKY A will harm kids and families, as well as an estimated 32% of the remainder of the funding. The 32% figure, which represents the most recent data available, does not apply to $11.5 million of cuts that would not fall on children or parents whatsoever.

[4] Though there appears to be an increase of $7.0 million from Current Services in the Care4Kids line item, this increase actually represents a reallocation from Other Services for the Office of Early Childhood's contract with United Way to administer the Care4Kids program, and a contract-mandated increase in rates for family child care and kith and kin providers. The proposal does not contain any increase in funding for program expansion, nor for an increase in rates for child care centers.

[5] Office of Early Childhood, "Federal Preschool Development Grant – Abstract," (October 2014) http://www.ct.gov/oec/lib/oec/initiatives/2014_pdg_abstract.pdf.

[6] U.S. Department of Health and Human Services, Administration for Children and Families, Early Childhood Development, "Preliminary Early Head Start-Child Care Partnership and Early Head Start Expansion Awards" (December 2014) http://www.acf.hhs.gov/programs/ecd/early-learning/ehs-cc-partnerships/grant-awardees.

[7] Line items for wraparound services and Parent Universities are included in the budget for the State Department of Education.

[8] National Institute for Education Research, "Is More Better? The Effects of Full-Day vs. Half-Day Preschool on Early School Achievement," (May 2006), available at http://nieer.org/resources/research/IsMoreBetter.pdf.

[9] The Governor's budget proposal does not contain any new funding for full-day kindergarten.

[10] See, Juan F. v. Malloy exit Plan, Quarterly Report, January 1, 2014 – March 31, 2014, Civil Action No. 2:89 CV 859 SRU. Available at http://www.ct.gov/dcf/lib/dcf/positive_outcomes/pdf/1st_qtr_report_2014_final.pdf.

[11] Source: CT Voices for Children analysis of State Department of Revenue data